

Headnote

An issuer's securities are converted into or redeemed for securities of another issuer - The investor could have acquired the underlying securities directly from the other issuer in compliance with the registration and prospectus requirements of the *Securities Act* at the time the investor acquired the convertible securities from the issuer

March 6, 2013

Exemption Order

**Aquinox Pharmaceuticals Inc. (Aquinox Canada)
and
Aquinox Pharmaceuticals (USA) Inc. (Aquinox US)
(collectively, the Filers)**

Section 76 of the *Securities Act*, R.S.B.C. 1996, c. 418 (the Act)

Background

- ¶ 1 The Filers have applied for an exemption under section 76 of the Act from the prospectus requirements under section 61 of the Act relating to trades of certain exchangeable shares and the granting of certain related options in securities made in connection with or resulting from a proposed Series C round financing (the Series C Financing) of the Filers (the Requested Relief).

Representations

- ¶ 2 The Filers represent that:
1. Aquinox Canada was incorporated under the *Canada Business Corporations Act* on December 26, 2003, and is not a reporting issuer or the equivalent in any jurisdiction in Canada;
 2. the head office of Aquinox Canada is located at Suite 430, 5600 Parkwood Way, Richmond, British Columbia V6V 2M2;
 3. Aquinox US was incorporated under the laws of the State of Delaware on May 25, 2007, and is not a reporting issuer or the equivalent in any jurisdiction in Canada;

4. Aquinox Canada's authorized capital currently consists of:
 - (a) ten common shares (New Common Shares);
 - (b) an unlimited number of common exchangeable shares (Common Exchangeable Shares);
 - (c) an unlimited number of Class A exchangeable preferred shares issuable in series (Series A-1 and A-2) (collectively, the Class A Exchangeable Preferred Shares);
 - (d) an unlimited number of Class B exchangeable preferred shares issuable in series (Series B-1 and B-2) (collectively, the Class B Exchangeable Preferred Shares);
 - (e) an unlimited number of special voting shares (the Special Voting Shares); and
 - (f) an unlimited number of non-voting preferred shares (Non-Voting Preferred Shares);
5. Aquinox Canada currently has 44 shareholders;
6. Aquinox US's authorized capital currently consists of common stock (Common Stock) and preferred stock divided into nine series, including Series A-1 Preferred Stock and Series A-2 Preferred Stock (collectively, the Series A Preferred Stock), Series A-1 Special Voting Stock and Series A-2 Special Voting Stock (collectively, the Series A Voting Stock), Series B-1 Preferred Stock and Series B-2 Preferred Stock (collectively, the Series B Preferred Stock), Series B-1 Special Voting Stock and Series B-2 Special Voting Stock (collectively, the Series B Voting Stock), and common special voting stock (Common Special Voting Stock);
7. under the exchangeable share structure implemented in connection with the Series A round and Series B round financings completed by the Filers in June 2007 and March 2010 respectively, Aquinox Canada and Aquinox US are "mirrored corporations", such that (a) the holders of Class A Exchangeable Preferred Shares and Series A Preferred Stock have equivalent economic rights and equivalent voting rights in each company, (b) the holders of Class B Exchangeable Preferred Shares and Series B Preferred Stock have equivalent economic rights and equivalent voting rights in each company, and (c) the holders of Common Exchangeable Shares and Common Stock have equivalent economic rights and equivalent voting rights in each company;
8. none of the securities of Aquinox Canada or Aquinox US are publicly traded;
9. Aquinox Canada and Aquinox US are not "affiliated" as that term is defined in National Instrument 45-106 *Prospectus and Registration Exemptions* (NI 45-106);

10. Aquinox Canada and Aquinox US are now proposing to complete the Series C Financing, under which Aquinox Canada and Aquinox US will issue up to US\$25 million of securities in the aggregate;
11. all of the Series C Investors (as defined below) will be “accredited investors” within the meaning of NI 45-106;
12. before completing the Series C Financing:
 - (a) Aquinox Canada will amend its constating documents to modify its existing share rights and to create an unlimited number of Class C exchangeable preferred shares (Class C Exchangeable Preferred Shares); and
 - (b) Aquinox US will amend its constating documents to modify its existing share rights and to create Series C Preferred Stock (Series C Preferred Stock) and Series C Special Voting Stock (Series C Special Voting Stock);
13. investors in the Series C Financing (Series C Investors) will have the choice of purchasing:
 - (a) units consisting of one Class C Exchangeable Preferred Share, one Special Voting Share and one share of Series C Special Voting Stock; or
 - (b) units consisting of one share of Series C Preferred Stock and one Special Voting Share;
14. in addition to receiving the securities described in paragraph 13(b), one U.S. investor will also receive warrants (Series C Warrants) entitling it to purchase units consisting of one share of Series C Preferred Stock and one Special Voting Share;
15. under the exchangeable share structure implemented in connection with the Series C Financing, the holders of Class C Exchangeable Preferred Shares and Series C Preferred Stock will have equivalent economic rights and equivalent voting rights in each company;
16. Aquinox US or a subsidiary of Aquinox US other than Aquinox Canada (a Permitted Subsidiary) will have overriding rights (collectively, the Call Rights) to purchase Class C Exchangeable Preferred Shares issued to the Series C Investors in exchange for shares of Series C Preferred Stock and to purchase Common Exchangeable Shares (including Common Exchangeable Shares issuable upon any exchange of Class A Exchangeable Preferred Shares, Class B Exchangeable Preferred Shares or Class C Exchangeable Preferred Shares) in exchange for shares of Common Stock:
 - (a) upon the liquidation, dissolution or winding up of Aquinox Canada;
 - (b) in the case of the Class C Exchangeable Preferred Shares issued to the Series C Investors:

- (i) upon any exercise of the retraction rights granted to holders of the Class C Exchangeable Preferred Shares; or
 - (ii) upon any redemption of the Class C Exchangeable Preferred Shares by Aquinox Canada; or
 - (c) in the case of the Common Exchangeable Shares (including Common Exchangeable Shares issuable upon the exchange of Class A Exchangeable Preferred Shares, Class B Exchangeable Preferred Shares or Class C Exchangeable Preferred Shares):
 - (i) upon any exercise of the retraction rights granted to holders of the Common Exchangeable Shares; or
 - (ii) upon any redemption of the Common Exchangeable Shares by Aquinox Canada;
17. subject to the Call Rights of Aquinox US or a Permitted Subsidiary, a holder of Class C Exchangeable Preferred Shares will be entitled to receive from Aquinox Canada shares of Series C Preferred Stock and a holder of Common Exchangeable Shares (including Common Exchangeable Shares issued upon the exchange of Class A Exchangeable Preferred Shares, Class B Exchangeable Preferred Shares or Class C Exchangeable Preferred Shares) will be entitled to receive from Aquinox Canada shares of Common Stock, in each case together with an additional amount equivalent to all declared and unpaid dividends on each such Class C Exchangeable Preferred Share or Common Exchangeable Share, as the case may be, upon:
- (a) the liquidation, dissolution or winding-up of Aquinox Canada; or
 - (b) the exercise by such holder of the retraction rights attaching to the Class C Exchangeable Preferred Shares or Common Exchangeable Shares held by such holder;
18. subject to the Call Rights of Aquinox US or a Permitted Subsidiary, Aquinox Canada will be entitled to redeem all of the Class C Exchangeable Preferred Shares and all of the Common Exchangeable Shares (including Common Exchangeable Shares issued upon the exchange of Class A Exchangeable Preferred Shares, Class B Exchangeable Preferred Shares or Class C Exchangeable Preferred Shares) upon the occurrence of certain events and, upon any such redemption, a holder of such Class C Exchangeable Preferred Shares will be entitled to receive from Aquinox Canada shares of Series C Preferred Stock and a holder of such Common Exchangeable Shares will be entitled to receive from Aquinox Canada shares of Common Stock, in each case together with an additional amount equivalent to all declared and unpaid dividends on each such Class C Exchangeable Preferred Share or Common Exchangeable Share, as the case may be, held by such holder on any dividend record date prior to such redemption;

19. Aquinox Canada, Aquinox US and their shareholders will amend the existing exchange agreement among them (the Exchange Agreement), which agreement, as amended, will, among other things, provide that:
 - (a) each holder of Class C Exchangeable Preferred Shares and Common Exchangeable Shares (including Common Exchangeable Shares issued upon the exchange of Class A Exchangeable Preferred Shares, Class B Exchangeable Preferred Shares or Class C Exchangeable Preferred Shares) will have an exchange right (the Optional Exchange Right), exercisable on the insolvency of Aquinox Canada or the failure of Aquinox Canada to pay the amounts payable upon the retraction of such holder's Class C Exchangeable Preferred Shares or Common Exchangeable Shares, to require Aquinox US to purchase all or part of such holder's Class C Exchangeable Preferred Shares in exchange for shares of Series C Preferred Stock or all or part of such holder's Common Exchangeable Shares in exchange for shares of Common Stock, in each case together with an additional amount equivalent to all declared and unpaid dividends on each such Class C Exchangeable Preferred Share or Common Exchangeable Share, as the case may be, held by such holder on any dividend record date prior to the closing of the purchase and sale; and
 - (b) upon the liquidation, dissolution or winding-up of Aquinox US, Aquinox US will be required to purchase all of the outstanding Class C Exchangeable Preferred Shares and Common Exchangeable Shares (including Common Exchangeable Shares issued upon the exchange of Class A Exchangeable Preferred Shares, Class B Exchangeable Preferred Shares or Class C Exchangeable Preferred Shares) and the holders of such shares will be required to sell such shares to Aquinox US (such obligations of purchase and sale are referred to as the Automatic Exchange Right):
 - (i) in the case of Class C Exchangeable Preferred Shares, in exchange for shares of Series C Preferred Stock, together with an additional amount equivalent to all declared and unpaid dividends on the Class C Exchangeable Preferred Shares; and
 - (ii) in the case of Common Exchangeable Shares, in exchange for shares of Common Stock, together with an additional amount equivalent to all declared and unpaid dividends on the Common Exchangeable Shares;
20. Aquinox Canada and Aquinox US will amend the existing support agreement between them (the Support Agreement), which agreement, as amended, will, among other things, provide that:
 - (a) Aquinox US will not declare dividends on its Series C Preferred Stock or Common Stock unless Aquinox Canada simultaneously declares equivalent dividends on the Class C Exchangeable Preferred Shares or the Common Exchangeable Shares, as the case may be;

- (b) Aquinox US will ensure that Aquinox Canada is able to fulfill its obligations in respect of the redemption and retraction rights and dissolution entitlements attached to the Class C Exchangeable Preferred Shares and the Common Exchangeable Shares; and
 - (c) except in certain circumstances, Aquinox US will not undertake certain rights offerings or share capital alterations unless the same or an economically equivalent offering or alteration is undertaken by Aquinox Canada, and vice versa;
21. as a result of the proposed issuance of securities under the Series C Financing, discretionary relief is necessary for:
- (a) trades of shares of Series C Preferred Stock or Common Stock as may from time to time be necessary to enable Aquinox Canada or Aquinox US (or a Permitted Subsidiary) to deliver such shares to a holder of Class C Exchangeable Preferred Shares or Common Exchangeable Shares (including Common Exchangeable Shares issued upon the exchange of Class A Exchangeable Preferred Shares, Class B Exchangeable Preferred Shares or Class C Exchangeable Preferred Shares) (and, if applicable, any delivery of shares between Aquinox US and a Permitted Subsidiary as may be required to carry out the Call Right), upon:
 - (i) the liquidation, dissolution or winding-up of Aquinox Canada;
 - (ii) the exercise by a holder of Class C Exchangeable Preferred Shares or Common Exchangeable Shares of the attached retraction rights;
 - (iii) the redemption of the Class C Exchangeable Preferred Shares or Common Exchangeable Shares by Aquinox Canada; or
 - (iv) the exercise by a holder of Class C Exchangeable Preferred Shares or Common Exchangeable Shares of the Optional Exchange Right or the occurrence of an event which triggers an Automatic Exchange Right,including, in the case of clauses (i), (ii) and (iii), trades in such securities in connection with or resulting from the exercise by Aquinox US (or a Permitted Subsidiary) of the Call Right;
 - (b) the transfer of Class C Exchangeable Preferred Shares or Common Exchangeable Shares to Aquinox US (or a Permitted Subsidiary) upon the exercise by Aquinox US (or a Permitted Subsidiary) of the Call Right in connection with:
 - (i) the liquidation, dissolution or winding-up of Aquinox Canada;
 - (ii) the exercise by a holder of Class C Exchangeable Preferred Shares or Common Exchangeable Shares of the attached retraction rights; or

- (iii) the redemption of the Class C Exchangeable Preferred Shares or Common Exchangeable Shares by Aquinox Canada;
- (c) the transfer of Class C Exchangeable Preferred Shares or Common Exchangeable Shares to Aquinox US upon the exercise by a holder of Class C Exchangeable Preferred Shares or Common Exchangeable Shares of the Optional Exchange Right or the occurrence of an event which triggers an Automatic Exchange Right (collectively, the Exchangeable Share Trades);
- (d) the grant of the following options (collectively, the Equivalency Options) to be granted in connection with the issuance of securities under the Series C Financing:
 - (i) options granted to Aquinox US by the holders of the Common Special Voting Stock entitling Aquinox US to purchase shares of the Common Special Voting Stock from such holders for nominal consideration;
 - (ii) options granted to Aquinox US by the holders of the Series C Special Voting Stock entitling Aquinox US to purchase shares of the Series C Special Voting Stock from such holders for nominal consideration;
 - (iii) options granted to Aquinox Canada by the holders of the Special Voting Shares issued in connection with the Series C Financing (including Special Voting Shares issued pursuant to the exercise of the Series C Warrants) entitling Aquinox Canada to purchase such Special Voting Shares from such holder for nominal consideration; and
 - (iv) options granted to the holders of Special Voting Shares by Aquinox Canada issued in connection with the Series C Financing (including Special Voting Shares issued pursuant to the exercise of the Series C Warrants) entitling such holders to purchase Special Voting Shares for nominal consideration;

in each case in order to align the number of shares of Common Special Voting Stock, Series C Special Voting Stock or Special Voting Shares, as the case may be, held by each holder with the number of shares of Common Stock that such holder would hold if all of the Common Exchangeable Shares, Class C Exchangeable Preferred Shares and Series C Preferred Stock held by such holder were exchanged or converted into shares of Common Stock.

Order

- ¶ 3 Considering that it is not prejudicial to the public interest, the Executive Director orders that the Requested Relief is granted in respect of the Exchangeable Share Trades and the granting of the Equivalency Options, provided that the first trade of a security acquired under this decision shall be a distribution unless such first trade complies with section 2.5 of National Instrument 45-102 *Resale of Securities* (NI 45-102), subject to section 2.7 of NI 45-102, if applicable.

Peter Brady
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British Columbia Securities Commission